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ORIGINAL

December 4,2002

Via hand delivery

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

Re: WCB Docket No. 01-338

Dear Ms. Dortch:

On December 4,2002, Praveen Goyal and Jason Oxman of Covad Communications met with Jordan Goldstein, Legal Advisor to Commissioner Copps, to discuss the Triennial Review proceeding. Covad's points are summarized in the attached presentation.

Respectfully submitted,

Florence Grasso

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Cc: Jordan Goldstein

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Connect Smarter.℠

Remote Terminal Loop Unbundling

Jason Oxman

Praveen Goyal

December 4, 2002

Need for Continued Access to Fiber-Fed Loops

- A bottleneck is a bottleneck – does not matter whether the loop is made of copper or glass. The Commission's loop analysis applies equally to all copper loops and copper/fiber loops.
- Today, hybrid fiber-copper loops account for approximately 21% of nationwide loop plant. (Covad Initial Joint Decl. ¶ 33 n. 14)
- The ILECs prevent Covad from providing service to more than one-fifths of all end users. In 2001, Covad was forced to turn away over 24,000 customers because of ILEC refusal to provide access (Covad Initial Comments at p. 58).
- Covad is and will continue to be the largest wholesale purchaser of stand-alone UNE loops, but BOCs still refuse, in the absence of an unbundling obligation, to consider Covad a true customer, and the unbundling obligation is the *only* incentive for BOCs to negotiate.
- Verizon PARTS tariff filing, and subsequent withdrawal by Verizon shows that reliance on "commercial negotiation" with ILECs cannot work. In the absence of an unbundling obligation, ILECs will continue to refuse to provide access to fiber-fed loops.

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Inability to Duplicate ILEC Loop Plant

- CLEC and ILEC costs to construct fiber feeder and NGDLC plant are not even close to being the same
- ILECs enjoy impossible-to-duplicate advantages in their loop plant
- Network infrastructure, including fiber-deployment, developed under rate-of-return cost recovery from captive ratepayers
- ILEC advantages include extensive rights-of-way, poles, ducts, conduits, existing copper plant, existing remote terminals, existing central offices, and unique economies of scale in labor and facilities costs

The Truth about DLC Investment

- Fiber feeder deployment saves the ILECs money. Fiber feeder pays for itself through the reduction in costs for maintaining legacy copper network facilities. Operating expenses for fiber feeder are cheaper than copper feeder plant.

- Numerous state commissions have found this to be true, determining that a hybrid fiber-copper network is the most efficient network design in TELRIC rate-setting proceedings.

- *Not just theory, but business fact.* Prior to Triennial Review, RBOCs openly touted the efficiencies gained from NGDLC deployment. "The network efficiency improvements alone will pay for this initiative...

  "[T]he efficiencies SBC expects to gain will pay for the cost of the deployment on an NPV basis. These efficiencies are conservatively targeted to yield annual savings of about $1.5 billion by 2004 ($850 million in cash operating expense and $600 million in capital expenditures)." *SBC* Announces Sweeping *Broadband* Initiative, SBC Investor Briefing, at 2 (October 18, 1999).

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CLEC/ILEC negotiation to implement loop unbundling can and should result in a commercially reasonable rate.

- Step one: Negotiation to implement RT loop unbundling rules.
  - Parties can and should reach a commercial deal -- the Act calls for negotiation first, and arbitration only as a last resort.
  - 1996 Act was not surplusage: Bells will never negotiate in the absence of an unbundling obligation. UNE loops must be unbundled.
- Step two: If negotiation fails, then arbitration before the state commission.
- FCC must set out specific guidance to the states to ensure that TELRIC pricing arbitration addresses investment incentive argument.
  - TELRIC "plus" would require reversal of prior Commission interpretation of the pricing provisions of the Act, and would contradict Verizon.
  - "Section 252(d)(1) states that rates for interconnection and access to unbundled elements "may include a reasonable profit." We find that the TELRIC pricing methodology we are adopting provides for such a reasonable profit and thus no additional profit is justified under the statutory language. . . . . The concept of normal profit is embodied in forward-looking costs because the forward-looking cost of capital, *i.e.*, the cost of obtaining debt and equity financing, is one of the forward-looking costs of providing the network elements. This forward-looking cost of capital is equal to a normal profit. We conclude that allowing greater than normal profits would not be "reasonable" under sections 251(c) and 252(d)(1)." Local *Comp.* Ord. at ¶¶ 699-700.

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Protecting Incentives to Invest

- UNE pricing consists of (1) the TELRIC of a network element, which has three components: operating expenses, depreciation costs, and risk-adjusted capital costs (Local Competition Order ¶ 703); and includes (2) recovery of a reasonable profit. *See* 47 USC § 252(d)(1).
- The Supreme Court has recognized the broad authority of state commissions to consider adjustments to depreciation and capital costs to account for particularly risky investments.
  - "TELRIC rates leave plenty of room for differences in the appropriate depreciation rates and risk-adjusted capital costs depending on the nature and technology of the specific element to be priced." *Verizon v. FCC*, 122 S.Ct. at 1678.
- Indeed, the BOCs themselves have promoted shortening depreciation schedules and raising cost of capital factors as the means to protect their incentives to engage in risky investments. *See, e.g.,* William Barr 7/16/02 letter and William Daley 9/4/02 letter to Chairman Powell.

FCC Guidance for State Arbitration Pricing Decisions (should negotiation fail)

- Cost of capital may be adjusted if ILEC proves it need be higher:
  - "[W]e conclude that the currently authorized rate of return at the federal or state level is a *reasonable starting point* for TELRIC calculations, and incumbent LECs bear the burden of demonstrating with specificity that the business risks that they face in providing unbundled network elements and interconnection services would justify a different risk-adjusted cost of capital or depreciation rate. . . . We recognize that incumbent LECs are likely to face increased risks given the overall increases in competition in this industry, which generally might warrant an increased cost of capital . . . ." *LCO* at ¶ 702 (emphasis added).
- Fill factors can be adjusted to ensure risk of low demand is accounted for:
  - "Per-unit costs shall be derived from total costs using reasonably accurate "fill factors" (estimates of the proportion of a facility that will be "filled" with network usage); that is, the per-unit costs associated with a particular element must be derived by dividing the total cost associated with the element by a reasonable projection of the actual total usage of the element." *LCO* at ¶ 682.

Specific direction to states, continued

- Joint and Common Costs can be adjusted:
  - "The forward-looking costs directly attributable to local loops, for example, shall include not only the cost of the installed copper wire and telephone poles but also the cost of payroll and other back office operations relating to the line technicians, in addition to other attributable costs." ***LCO*** at ¶ 682.
- Depreciation factor can be adjusted:
  - "[P]roperly designed depreciation schedules should account for expected declines in the value of capital goods." *LCO* at ¶ 686.